

Joint Legislative Budget Committee

Staff Memorandum

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DATE: October 15, 2007

TO: Members, Joint Legislative Budget Committee

FROM: Richard Stavneak, Director

SUBJECT: FY 2008 REVENUE AND ENDING BALANCE PROJECTION

Pursuant to Laws 2007, Chapter 255, the JLBC Staff is required to report to the Committee by October 15, 2007 as to whether the estimated FY 2008 General Fund revenues and ending balance are expected to change by more than \$50 million from budgeted projections.

The JLBC Staff does anticipate that the FY 2008 ending balance will fall short of the budget by more than \$50 million due primarily to a lower than budgeted carry-forward from FY 2007, as well as lower than anticipated revenue collections in FY 2008. As previously reported in the "September Monthly Fiscal Highlights," our current FY 2008 revenue shortfall estimate is \$(525) million to \$(675) million. The ending balance shortfall is in the same range. These estimates do not reflect potential supplementals.

As discussed below, there are 3 main factors which we anticipate will influence the magnitude of the shortfall in the FY 2008 ending balance.

FY 2007 Revenue Performance

As enacted in June, the FY 2007 General Fund revenue forecast (excluding the beginning balance) was \$9.85 billion. Preliminary actual FY 2007 revenue collections fell short of this forecast by approximately \$(226) million. As a result, the amount of revenue collections which will carry forward into FY 2008 will be \$(226) million less than anticipated.

The actual amount of the carry-forward will also depend on the level of final FY 2007 spending. The General Appropriation Act requires that the Executive Branch submit a preliminary estimate of the FY 2007 ending balance by September 15, 2007. The Executive has not yet submitted this report.

While the JLBC Staff has already calculated a preliminary FY 2007 revenue number, the Executive estimates would provide an initial perspective on the level of unspent FY 2007 appropriations, otherwise known as "revertments." The budget annually includes an estimate for revertments, which can be especially significant if caseloads in entitlement programs are less than anticipated. The FY 2007 budget, as revised during the last session, included estimated revertments of \$113 million.

Based on a JLBC Staff analysis, we believe that FY 2007 revertments may be significantly higher than expected, which would offset some of the \$(226) million revenue shortfall. The Department of Education and the Arizona Health Care Cost Containment System (AHCCCS) both appear to have had FY 2007 caseloads that fell below budget. As a result, revertments may be as high as \$216 million, which would provide \$103 million in savings above the budgeted amount and would offset the \$(226) million revenue loss from FY 2007.

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Some of these savings may evaporate in FY 2008. Agencies have a year to use their revertments to pay any remaining bills from FY 2007. Nonetheless, it is important to get an initial reading on our FY 2007 book closing so that any estimates of the FY 2008 shortfall can be further refined.

FY 2008 Revenues

The enacted FY 2008 budget was based on a total revenue forecast (excluding the beginning balance), of \$10.08 billion. This amount assumed a base revenue growth rate of 6%. Based on the lower than expected FY 2007 collections noted above, the enacted budget forecast amount would require a base growth rate for FY 2008 of 8.4% in order to achieve the forecasted dollar amount.

Due to several factors, revenue growth is expected to be significantly slower than the growth rate required to meet the budgeted forecast. Based on preliminary data, General Fund revenues are only 1.6% above FY 2007 collections for the first 3 months of the fiscal year. Based on preliminary projections, revenues are expected to be approximately \$(150) million below forecast for the 1st quarter.

Additionally, the JLBC's 4-sector consensus forecasting model provides a significantly more cautious view of the economy than the enacted budget forecast. The consensus methodology equally weights the forecasts from the Finance Advisory Committee and the JLBC Staff and 2 University of Arizona econometric models. The September 4-sector consensus forecast for FY 2008 base revenue growth is 3.5%, compared to 8.4% in the enacted budget.

FY 2008 Spending

The FY 2008 ending balance will also depend on whether we meet spending projections. Five of the largest agencies report either monthly or bi-monthly on their spending. Two agencies are currently reporting shortfalls.

- Arizona Department of Education (ADE) - ADE reports no shortfall.
- AHCCCS - Caseloads are currently above the forecast utilized in the FY 2008 budget. In its most recent Appropriation Status Report, the department estimated the current size of its General Fund shortfall to be \$(57) million.
- Department of Economic Security - The department is evaluating potential shortfalls and funding solutions in several areas but has not listed a specific shortfall amount.
- Department of Health Services (DHS) - Caseloads are currently above the forecast utilized in the FY 2008 budget. The department, however, is not currently reporting a shortfall.
- Arizona Department of Corrections (ADC) - ADC reports no shortfall.

In addition to these agencies, the School Facilities Board reports they may have a FY 2008 shortfall of (\$73) million due to new school construction expenses.

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